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BEFORE THE ARIZONA CORPORATION COMMISSION

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Commissioner

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Commissioner

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Commissioner

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Commissioner

AZ CORP COMMISSION
DOCUMENT CONTROL

IN THE MATTER OF QWEST
CORPORATION'S FILING AMENDED
RENEWED PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE
INVESTIGATION OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

QWEST CORPORATION'S
POST-HEARING BRIEF

I. INTRODUCTION

Qwest Corporation ("Qwest") hereby submits its Post-Hearing Brief in support of the Settlement Agreement and new Price Cap Plan negotiated by the parties in the above-captioned matter. Under the terms of the Agreement, Qwest has agreed to a number of consumer benefits, including price constraints, price reductions, and overall revenue restrictions on rate increases in exchange for the opportunity to raise or adjust prices for its most competitive services.

The provision of telecommunications service has become an increasingly complex and competitive business throughout Arizona. The Settlement Agreement and new Price Cap Plan are the product of thorough consideration and the careful balancing of the many varied interests and intricate issues raised by the parties to the Agreement. These parties include not only Qwest, but also: the Arizona Corporation Commission ("Commission") Utilities Division Staff ("Staff"); local competitors—MCI, Inc. ("MCI"), Time Warner

1 Telecom of Arizona, LLC ("Time Warner"), Cox Arizona Telecom, LLC ("Cox"), and XO
2 Communications Services, Inc. ("XO"); customers—the Department of Defense and All
3 Other Federal Executive Agencies ("DOD-FEA"); and investors—the Arizona Utility
4 Investors Association ("AUIA"). Overall, the Settlement Agreement and the new Price
5 Cap Plan serve the public interest and, therefore, Qwest requests that the Commission
6 approve them as submitted by the parties.

7 **II. SUMMARY OF PRICE CAP PLAN**

8 The Settlement Agreement provides a thoughtfully balanced plan of alternative
9 regulation. It includes targeted benefits for consumers, including reductions in rates for
10 Qwest services purchased by its customers and competitors. It further recognizes the
11 increasingly competitive market for telecommunications service in Arizona, with
12 movement toward cost-saving reductions in regulatory requirements and the provisions of
13 incentives for Qwest to offer new and different competitive consumer choices. Finally, the
14 Agreement resolves complex accounting issues and eliminates certain legal disputes
15 between the parties.

16 Key provisions of the Settlement Agreement and the new Price Cap Plan include the
17 following:

18 • The parties recognize that Qwest is significantly under-earning in Arizona
19 and entitled to rate relief under Arizona law. In order to comply with the State's fair value
20 requirement, the parties have agreed that Qwest's jurisdictional fair value rate base is
21 \$1,507,745,000 and its corresponding revenue deficiency is \$31.8 million (based upon the
22 following compromise of their original positions):

23 ///

24 ///

25 ///

26 ///

	QWEST	RUCO	STAFF	AGREEMENT
ORIGINAL COST:				
Rate Base	\$1,717 million	\$1,489 million	\$1,560 million	N/A
Rate of Return	11.18%	8.73%	9.50%	N/A
Revenue Deficiency	\$275.0 million	\$159.5 million	\$3.5 million	N/A
FAIR VALUE:				
Rate Base	\$2,141 million	\$2,285 million	\$2,229 million	\$1,508 million
Rate of Return	11.18%	5.69%	6.65%	9.50%
Revenue Deficiency	\$355.4 million	\$159.5 million	\$3.5 million	\$31.8 million

- The new Price Cap Plan will consist of four baskets—three for retail services and one for wholesale services. The services assigned to each basket will remain within their respective baskets for the three-year term of the Settlement Agreement and Plan.

- Qwest will make reductions to its switched access charges (Basket 4) in an annual amount totaling \$12 million at the start of the first year of the new Price Cap Plan. The switched access reductions are permanent and will be revenue neutral through increases in prices for services in Baskets 2 or 3.

- Qwest will have the opportunity to increase its revenue through limited price changes in Baskets 2 and 3 during the term of the new Price Cap Plan. In Year 1 of the Plan, the allowable net increase in revenues resulting from these price changes cannot exceed \$31.8 million, as allocated between the two baskets. In Years 2 and 3, the allowable net increase to the price cap will be no more than \$43.8 million per year.

1 • Qwest will offer Time Warner, XO and other carriers intrastate DS1 private
2 line services on a contract basis according to the same terms, conditions and prices
3 contained in Attachment D of the Settlement Agreement.

4 • Under Decision Nos. 66772 and 67047 (currently on appeal), the
5 Commission forced Qwest to make certain annual price adjustments. In Decision No.
6 66773, however, the Commission suspended the last adjustment (originally scheduled for
7 April 1, 2005), provided that any final rates approved in this docket would somehow
8 provide ratepayers with the full credit for the value of that suspended adjustment. To
9 achieve this result, Qwest has agreed to a \$12 million reduction in its allowable revenue
10 increase for Year 1 of the new Price Cap Plan. Additionally, Qwest will dismiss its appeal
11 of the Commission decisions ordering the adjustments. The existing productivity
12 adjustment mechanism for Basket 1 is eliminated on a going-forward basis.

13 • Qwest will implement additional consumer benefits valued at approximately
14 \$5.5 million annually, including reductions in zone charges, reductions to non-published
15 and non-listed telephone number rates, and an increase in funding for the Telephone
16 Assistance Plan for the Medically Needy ("TAP").

17 • Qwest will withdraw many of its more controversial proposals originally
18 requested in this case, such as its proposal for competitive zones in Arizona and its request
19 for \$64 million in Arizona Universal Fund ("AUSF") support.

20 It is important to note that the Settlement Agreement and the new Price Cap Plan
21 were the result of an extensive negotiation process that commenced on February 1, 2005,
22 with public notice seeking the participation of all interested parties. Most of the entities
23 that intervened in this docket were involved in the negotiation process. Due to the
24 complexity and number of issues involved, subgroups were formed to address specific
25 topics. The negotiations successfully concluded after six months of intense work and
26 compromise by all participating parties. With the exception of the Residential Utility

1 Consumer Office ("RUCO"), which voluntarily chose to withdraw from the settlement
2 negotiations after only two months, and the Arizona Consumers Council ("ACC"), which
3 never participated at all, the Settlement Agreement is supported by all other parties to this
4 case, including Staff, MCI, Time Warner, Cox, XO, DOD-FEA, and AUIA.

5 **III. STANDARD FOR APPROVING SETTLEMENT AGREEMENTS**

6 The Commission reviews and approves settlement agreements resolving rate cases
7 and other disputes to determine whether the agreement at issue is just and reasonable and in
8 the public interest. See *In the Matter of the Application of U S WEST Communications,*
9 *Inc., a Colorado Corporation, for a Hearing to Determine the Earnings of the Company,*
10 *Etc.*, Docket Nos. T-01051B-99-0105 and T-01051B-00-0369, Decision No. 63487 (March
11 30, 2001) at 25 (Conclusions of Law, ¶ 4); *In the Matter of U S WEST Communications,*
12 *Inc.'s Compliance with § 271 of the Telecommunications Act of 1996*, Docket Nos.
13 T-00000A-97-0238, RT-00000F-02-0271, and T-01051B-02-0871, Decision No. 66949
14 (April 30, 2004) at 54 (Conclusions of Law, ¶ 8). See also, *In the Matter of the Application*
15 *of Arizona Public Service Company for a Hearing to Determine the Fair Value of the*
16 *Utility Property of the Company for Ratemaking Purposes, etc.*, Docket No. E-01345A-03-
17 0437 at 41 (April 7, 2005) (Conclusions of Law, ¶ 4 & ¶ 6); *In the Matter of the*
18 *Application of Pine Water Company for a Determination of the Current Fair Value of its*
19 *Utilities Plant and Property, etc.*, Docket No. W-03512A-03-0279 at 13 (August 13, 2004)
20 (Conclusions of Law, ¶ 4 & ¶ 5).

21 **IV. THE SETTLEMENT AGREEMENT SERVES THE PUBLIC INTEREST**
22 **AND SHOULD BE APPROVED.**

23 The Settlement Agreement and new Price Cap Plan represent a fair and reasonable
24 compromise of the contested issues in this case, which have been pending since May 20,
25 2004.¹ They contain several key provisions that protect and benefit the public. The

26 ¹ In actuality, these issues have been before the Commission since July 1, 2003, when

1 Settlement Agreement has both quantifiable consumer benefits that total \$5.5 million
2 annually and additional benefits that cannot be quantified because they are non-monetary
3 in nature or the number of impacted customers cannot be determined. *See* Supplemental
4 Testimony of David L. Ziegler, Executive Summary at i (Sept. 6, 2005) (“Ziegler/ST”);
5 Supplemental Testimony of Elijah O. Abinah, Executive Summary (Sept. 6, 2005)
6 (“Abinah/ST”).

7 The Agreement’s quantifiable benefits include the reduction in zone charges, the
8 reductions in residential non-published and residential non-listed telephone listings, and the
9 increase in funding for TAP. *Id.* With respect to zone charges, current Zone 1 and Zone 2
10 charges will be cut in half to \$0.50. and \$1.50, respectively. Abinah/ST at 9. Similarly,
11 non-published and non-listed telephone number rates will be reduced to \$1.15 (by
12 approximately 30%) and \$0.80 (by approximately 39%), respectively. *Id.* Qwest will also
13 double its annual TAP funding to \$2 million per year. *Id.*

14 Consumer benefits that are not quantified in monetary terms include changes to
15 Qwest’s service quality tariff, increased line extension credits, a rate cap on directory
16 assistance, and the hard cap on Basket 1 services. *See* Ziegler/ST, Executive Summary at
17 I; Abinah/ST, Executive Summary. The Settlement Agreement provides rate stability by
18 continuing the hard cap on existing residential and business local exchange rates for an
19 additional three years. Abinah/ST, Executive Summary. It also caps the existing rate for
20 directory assistance at \$1.15 per call (rather than pricing directory assistance at the higher
21 market rate). Ziegler/ST at 4-5. This includes one call allowance per month without
22 charge and two inquires per usage and call completion. *Id.* The Agreement also increases
23 Qwest’s current one-time credit for establishing telephone service and constructing
24 facilities to locations in rural areas outside of the Base Rate Area of an exchange by 67%.
25 Abinah/ST at 0-10; Ziegler/ST at 8. Finally, the Agreement modifies Qwest’s current
26 Qwest filed its application seeking revision of the current Price Cap Plan.

1 service quality tariff to provide for, in part: (1) customer credits, (2) increased/decreased
2 ranges for penalties and penalty offsets based on Qwest's actual performance; and (3) an
3 objective standard for Qwest trouble reports. Ziegler/ST at 5-6.

4 The Settlement Agreement further provides that Qwest voluntarily reduce its
5 switched access prices immediately by \$12 million, while allowing Qwest the opportunity
6 to recover this reduction, as well as Qwest's \$31.8 million revenue deficiency, through
7 Basket 2 and 3 price increases. Supplemental Direct Testimony of Don Price (MCI) at 5
8 (Sept. 6, 2005) ("Price"); Testimony in Support of Settlement of Richard B. Lee 4 (Sept. 6,
9 2005) ("Lee/ST"). It also provides a volume and term alternative for intrastate special
10 access DS1 services for competitive carriers thereby enhancing competitive choice
11 opportunities for Arizona business customers. Direct Testimony of Rex Knowles (XO) at
12 3-4 (Sept. 6, 2005) ("Knowles"); Testimony of Brian D. Thomas (Time Warner) at 6 (Sept.
13 6, 2005) ("Thomas"). These two provisions are supported by those competitive local
14 exchange carriers most affected. Price at 5 (characterizing the Settlement as achieving "an
15 appropriate compromise that results in meaningful intrastate switched access reductions"
16 and "addressing" concerns raised by the Commission in its generic access docket). *See*
17 *also*, Knowles at 3-4 ("[t]he Arizona rate set by Section 9 and Attachment D in the
18 Settlement Agreement will enhance opportunities for competition and provide rate
19 stability"); Thomas, Summary (stating that "the reduction of rates on DS1 channel
20 terminations will provide benefits to competition in Arizona").

21 Significantly, the Settlement Agreement resolves the many contested issues
22 surrounding Qwest's revenue requirement and other accounting issues. Again, the parties
23 have agreed that Qwest's jurisdictional revenue deficiency is \$31.8 million. Lee/ST at 2.
24 This agreed-upon revenue deficiency is only approximately ten percent of the revenue
25 deficiency originally proposed by Qwest, and is about \$130 million less than what RUCO
26 originally proposed. Rebuttal Testimony in Support of Settlement of Richard B. Lee at 3

1 (Oct. 28, 2005) ("Lee/RT"). In order to provide rate stability, the parties have further
2 agreed to a three-year term for the Plan during which they will not initiate any general rate
3 case proceeding. Lee/ST at 2.

4 Specific RUCO and ACC criticisms attacking these provisions are without merit.
5 See Lee/RT at 4. As discussed previously, the Settlement Agreement was the product of
6 intense and lengthy negotiations. *Id.* RUCO voluntarily quit the negotiations after only
7 two months; and the ACC never participated at all. *Id.* Rejection of the Settlement
8 Agreement would result in full-scale litigation of issues such as Qwest's revenue
9 requirement. Given the fact that two of the three parties performing fair value calculations,
10 including RUCO, testified to significantly higher revenue deficiencies (*see supra* at 2-3),
11 the risk involved in such litigation is high and could easily result in rate increases and the
12 loss of negotiated consumer benefits so that Qwest may earn a constitutional return on its
13 investment in Arizona. Rejection of the Settlement Agreement therefore "fails to serve the
14 public interest" and "would place a chill over the prospects for the resolution of complex
15 matters through good faith negotiations." *Id.* ("[P]arties in future proceedings might profit
16 by avoiding the 'give and take' of negotiations" and thus "find [themselves] able to 'take'
17 without 'giving.'").

18 The Settlement Agreement also resolves a variety of intricate accounting issues
19 between the parties, including disputes over accounting for internal-use software,
20 accounting for other post-employment benefits, and accounting for depreciation. Abinah
21 S/T at 6-7; Supplemental Testimony of Steven C. Carver (Staff) at 3-7 (Sept. 6, 2005)
22 ("Carver"); Supplemental Testimony of William Dunkel (Staff) at 2-3 (Sept. 5, 2005)
23 ("Dunkel"). Many of these accounting issues have no clear Commission guiding
24 precedent, making their outcome dubious and creating the risk of "a significantly higher
25 overall revenue requirement than has been agreed to in the Settlement." Carver at 4-5. The
26 compromise reached on these complex issues is therefore fair and reasonable, and in

1 certain instances, favored Staff. For example, Qwest originally recommended depreciation
2 rates that would reduce its test year intrastate annual depreciation expense by \$155 million,
3 while Staff sought a \$253 million reduction. Direct Testimony of Philip E. Grate in
4 Support of Settlement at 9-10 (Sept. 6, 2005) ("Grate/DT"). The Settlement Agreement
5 calls for a \$4 million greater reduction in depreciation expense than what Staff proposed,
6 and the reduction in test year depreciation expense reduces Qwest's calculated revenue
7 requirement by \$119.6 million. *Id.* Qwest will also use, on a going-forward basis, longer
8 depreciation lives than those ordered by the Commission in Qwest's last depreciation case.
9 *Id.* at 10.

10 With regard to the new Price Cap Plan, one significant change or improvement is
11 the elimination of the annual productivity adjustment. Supplemental Testimony of
12 Matthew Rowell (Staff) at 3 (Sept. 6, 2005) ("Rowell/ST"). Staff and other parties to the
13 Agreement did not support the continuation of the productivity/inflation adjustment factor
14 as most states have abandoned its use. *Id.* at 6. Staff explained that because Qwest is now
15 subject to competition in its core business and is losing lines as a result of that competition,
16 continuation of the productivity adjustment would be neither appropriate nor a necessary
17 incentive, given Qwest's declining revenues. *Id.* at 6-7. For example, if the productivity
18 factor calculation were refreshed with current data, the result would be a productivity factor
19 of negative 4.0 percent, not the existing plan's positive 4.2 percent factor. Rebuttal
20 Testimony of Philip E. Grate at 19 (Oct. 28, 2005) ("Grate/RT").

21 Additionally, under the Agreement, the basket structure of the plan has been revised
22 to include a fourth basket, separating the current Basket 1 services into two: (1) for hard
23 capped services and (2) for other services having a 25% annual cap on price increases.
24 Rowell/ST at 4. This separation is more straightforward, provides clarity and enables
25 better regulatory oversight given the nature of the specific services contained in each
26 basket. *Id.*

1 Finally, approval of the Settlement Agreement will result in the dismissal of two
2 pending Qwest appeals currently before the Court of Appeals, Division 1. Abinah/ST at
3 21. Staff itself has characterized this term as “critical” to achieving any settlement of this
4 case. *Id.* at 22. The reason for its significance is clear—continuation of such litigation
5 risks the possible vacation of Commission Decision No. 67047, at which time Qwest
6 would be entitled to recover millions of dollars for productivity adjustments and other
7 reductions wrongfully compelled thereunder.

8 **V. RUCO’S LIMITED CHALLENGES TO THE SETTLEMENT**
9 **AGREEMENT ARE WITHOUT MERIT.**

10 **A. Competition In Arizona’s Telecommunications Market Necessitates The**
11 **Modification Of The Existing Price Cap Plan And Supports The**
12 **Adoption Of The Settlement Agreement**

13 Both RUCO and the ACC contend that the current telecommunications market in
14 Qwest’s service territory in Arizona is not sufficiently competitive to warrant Commission
15 approval of the Settlement Agreement and the new Price Cap Plan. Although briefly
16 referencing the current state of telecommunications competition in Arizona, RUCO and the
17 ACC discount the ever-expanding effects of wireless and Voice over Internet Protocol
18 (“VoIP”) competition in Arizona. They ignore the fact that under the new Plan, which
19 calls for statewide averaged Qwest local exchange rates, customers in rural areas of
20 Qwest’s service territory also will benefit from competition in the more urban areas of the
21 State, such as Phoenix and Tucson. While discounting competition in Arizona as
22 “insufficient,” RUCO and the ACC neither present any current facts nor conduct any
23 studies or substantive analyses to support their opinions. They simply criticize the
24 Settlement Agreement without any real evidentiary basis and without offering any
25 meaningful solutions to the “problems” they conjure.

26 By contrast, Qwest, Staff and other parties to this docket presented evidence of
significant CLEC-based competition in Arizona, as well as competition through

1 “intermodal” wireless and VoIP alternatives. Rebuttal Testimony of David L. Teitzel at
2 3-11 (Oct. 28, 2005) (“Teitzel/RT”). With the exception of RUCO and the ACC, the
3 parties agree that this Arizona competition continues to increase both in its intensity and
4 diversity. *See, e.g.*, Teitzel/RT at 49; Rebuttal Testimony in Support of Settlement of
5 Richard B. Lee at 5-6 (Oct. 28, 2005) (“Lee/RST”). For example, in the 17 months since
6 Qwest filed its direct testimony in this docket, Qwest has lost over 200,000 retail lines
7 beyond its original loss of 577,000 lines through December 2003. Teitzel/RT at 6 &
8 Highly Confidential Exhibit DLT-2. *See also*, Lee/RT at 6. Other radical changes have
9 altered the telecommunications market and will continue to drive such changes. Consistent
10 with national trends (Teitzel/RT at 31-33), the number of Arizona wireless subscribers has
11 now grown to 3,299,222 and now exceeds the *combined* total of 3,159,283 ILEC and
12 CLEC access lines in the State. Teitzel/RT at 4. At the time of hearing, the SBC/AT&T
13 and Verizon/MCI mergers were progressing through the regulatory approval process, and
14 upon their completion, will mark the end of the existence of the first and second largest
15 national interexchange carriers as independent market competitors.² Teitzel/RT, Executive
16 Summary at ii. Major telecommunications companies such as SBC/AT&T and
17 Verizon/MCI are now actively marketing VoIP services, and the recent purchase of Skype
18 by eBay will accelerate the adoption of “free” VoIP telephone services as yet another
19 alternative to traditional telephone service. Teitzel/RT Executive Summary at ii. *See also*,
20 *id.* at 38-41.

21 These are just a few examples of the many significant market developments that
22 have occurred in the past 17 months. Qwest’s financial performance in Arizona reflects the
23 effect of this competition. Qwest witness, Philip Grate, testified that in the last four and
24 one-half years, Qwest’s local service monthly revenues have declined 38 percent.
25 Grate/RT at 27. There is little doubt that the Arizona telecommunications market is

26 ² The SBC/AT&T merger recently closed over the 2005 Thanksgiving week.

1 competitive and that such competition will continue to evolve and grow throughout the
2 State. The present level of telecommunications competition in Qwest's Arizona service
3 territory and continuing developments require the current Price Cap Plan be amended to
4 reflect such changes and fully warrants Commission approval of the Settlement
5 Agreement.

6 **B. RUCO's Challenges to Scope of Settlement**

7 1. Geographic De-Averaging

8 RUCO asserts that the Settlement Agreement does not adequately address
9 differences in the level of competition across geographic areas. Johnson at 19 (claiming
10 that the Agreement "leaves customers in high cost rural areas vulnerable to excessive price
11 increases."). Instead, RUCO advocates that prices should be de-averaged and the
12 assignment of services to baskets under the new Price Cap Plan should be determined
13 based on "wire-center" geography, so that one service could be in multiple baskets
14 depending on location. RUCO's advocacy is extremely complex, impractical to
15 implement, impossible for customers to understand, and does not serve the public interest.

16 First, under the Settlement Agreement, the rates associated with Qwest's basic
17 business and residential services are hard-capped and cannot be increased during the
18 duration of the Plan. Further, for its non-basic services, Qwest cannot raise any rates in
19 rural areas without also raising the same rates in urban areas, irrespective of whether
20 competition exists there or not. Rebuttal Testimony of Matthew Rowell at 11 (Oct. 28,
21 2005) ("Rowell/RT"). The Agreement continues the current, long-standing regime of
22 state-wide averaged rates. *Id.* Thus, if Qwest were to raise a particular rate in order to take
23 advantage of any alleged "monopoly" position in rural areas, it would face the substantial
24 risk of losing customers to competition in urban areas. *Id.* Competition in urban areas will
25 restrict Qwest's ability to raise rates in other areas of the State.³ *Id.*

26 ³ RUCO's claim that statewide averaging causes rates to be higher than they should be in

1 By contrast, under RUCO's proposal, Qwest would be able to increase its rates
2 (including basic service rates) by as much as 25 percent per year. Rowell/RT at 13.
3 Because RUCO would not link urban and rural rates any longer, Qwest could cut rates or
4 keep rates constant in urban areas where there is more competition while simultaneously
5 raising rates to meet costs in rural areas as much as 25 percent. *Id.*

6 RUCO also ignores the direct benefits provided to rural customers under the
7 Settlement Agreement. *Id.* For example, under Section 13(a) of the Agreement, Zone 1
8 charges are reduced from \$1.00 to \$0.50 per month and Zone 2 charges from \$3.00 to
9 \$1.50. *Id.* In addition, exchange zone increment rates, which apply to customers whose
10 locations are considerable distances from Qwest central offices, are hard-capped. *Id.*

11 Most carriers in Arizona utilize state-wide averaging. Rebuttal Testimony of Jerrold
12 L. Thompson at 20 (Oct. 28, 2005) ("Thompson/RT"). Although RUCO claims the
13 continuation of state-wide averaging is a barrier for competitive carriers, intervening
14 CLECs as a whole support the adoption of the Settlement Agreement. *Id.*

15 Moreover, the Settlement Agreement provides a means for accommodating future
16 de-averaging at such time as the Commission decides to make changes to statewide
17 average pricing for Qwest and others. *Id.* at 20-21. The Commission has pending a
18 generic docket designed to review the state of competition in Arizona and to address such
19 issues in terms of its impact on the State, carriers and customers, as a whole. *See*
20 *generally, In the Matter of the Generic Investigation of Competition in Arizona Telecom*
21 *Market*, Commission Docket No. T-000001-04-0749. Although RUCO advocates that a
22

23 urban markets is dubious at best. Again, all evidence presented in this case demonstrates
24 that there is significant competition in Arizona's urban areas, through traditional landline
25 service, wireless and VoIP. All parties agree that competition drives the prices toward
26 their costs and that price-constraining competition exists in the Phoenix and Tucson
metropolitan areas. RUCO's argument ignores the economic effects of competition
where it is already entrenched. Teitzel/RT at 50; Rowell/RT at 12.

1 study of the impact of geographic de-averaging should be done, it has not, in fact,
2 performed any such analysis itself to support its position in this case. Rowell/RT at 12. The
3 Commission's generic docket is the more appropriate place in which to conduct this
4 review. Thompson/RT at 21.

5 2. AUSF

6 RUCO criticizes the Settlement Agreement because it does not include provisions
7 for reshaping the AUSF. Responsive Testimony of Ben Johnson, Ph.D. at 19-20 (Oct. 14,
8 2005) ("Johnson"). It is important to note, however, that RUCO makes no
9 recommendation for specific changes in the AUSF. *Id.*; Rowell/RT at 13.

10 Subsequent to Qwest's Rule 103 filing in this case, the Commission solicited
11 comments from interested parties in an industry-wide rulemaking docket to examine
12 possible changes to the AUSF. Thompson/RT at 19. At the present, there is clearly no
13 consensus among stakeholders concerning what changes are necessary to accomplish
14 meaningful AUSF relief. *Id.* See also, Rowell/RT at 13-14. However, Qwest has always
15 maintained that such reform must be done in a manner that applies equally and neutrally
16 among all carriers. See, e.g., *In the Matter of the Review and Possible Revision of Arizona*
17 *Universal Service Fund Rules, Etc.*, Docket No. RT-00000H-97-0137, Qwest Corporation's
18 Notice of Filing its Comments on Questions Related to the Possible Revision of Arizona
19 Universal Service Fund Rules at 2 (Nov. 2, 2001). See also, *id.*, Qwest Corporation's
20 Comments in Response to the Arizona Local Exchange Carriers Association's Proposal for
21 Amending the Arizona Universal Fund Rules, Etc. at 3 (Jul. 1, 2005). The Commission's
22 generic docket is the more appropriate vehicle through which to seek such improvements to
23 the AUSF, and RUCO will have the ability to pursue its advocacy there. Thompson/RT at
24 19; Rowell/RT at 13-14.

25 Moreover, the new Price Cap Plan includes provisions to incorporate any
26 modification to the AUSF that the Commission may deem appropriate through its generic

1 docket, as those provisions may affect Qwest. Thompson/RT at 19-20. For example,
2 Qwest is permitted to reflect AUSF assessments in its charges and should it receive
3 funding, its retail revenues may be adjusted accordingly. *Id.* at 20. Thus, the Settlement
4 Agreement and the new Price Cap Plan provide a practical means through which future
5 changes to AUSF may be implemented for Qwest.

6 3. Productivity Adjustment

7 RUCO infers that the Settlement Agreement's elimination of the annual
8 productivity adjustment is problematic. Johnson at 12. As explained previously, none of
9 the parties to the Agreement support the continuation of the productivity/inflation
10 adjustment factor. Rowell/ST at 6. In fact, most states have abandoned the use of such an
11 adjustment. *Id.* at 6-7. As Staff explained, Qwest is now subject to significant competition
12 and is losing lines and revenue, resulting in (as RUCO admits) a significant revenue
13 deficiency. *Id.* at 6. Under such circumstances, the use of a productivity adjustment as a
14 means of "passing on a carrier's reasonably anticipated increases in productivity" makes no
15 sense and will not provide appropriate incentives to Qwest. *Id.* See also, Rebuttal
16 Testimony of Philip E. Grate at 13 (Oct. 28, 2005) ("Grate/RT"). Moreover, the Settlement
17 Agreement does not eliminate the productivity factor alone; it also eliminates the
18 adjustment for inflation, effectively establishing a productivity offset equal to the rate of
19 inflation. Grate/RT at 15. Even RUCO's own witness (Johnson) acknowledges that the
20 productivity adjustment might need to be eliminated or revised. Transcript of Proceedings,
21 Vol. II at 414 (Nov. 2, 2005).

22 4. April 1, 2005 Productivity Reduction

23 Similarly, RUCO complains that the Settlement Agreement does not effectuate the
24 April 1, 2005 productivity adjustment due under prior Commission decisions because "it
25 does not render ratepayers in a better position than they were before the settlement
26 agreement." Supplemental Testimony in Opposition to Qwest's Settlement Agreement of

1 MaryLee Diaz Cortez at 4-5 (Oct. 14, 2005) ("Cortez"). The argument is simply wrong.
2 Decision No. 67734 does not call for a rate reduction. Grate/RB, Executive Summary at i.
3 Rather, it calls for ratepayers to receive full credit for the rate reduction. *Id.* RUCO fails to
4 acknowledge that because Qwest is entitled to recover its stipulated \$31.8 million revenue
5 deficiency (an amount that is \$127.7 million smaller than RUCO's calculated deficiency of
6 \$159.5 million), reducing that recovery by \$12 million in Year 1 bestows a \$12 million
7 benefit on Arizona ratepayers, giving them full credit for the rate reduction that would have
8 been in effect between April 1, 2005 and April 1, 2006. *Id.*

9 On cross-examination, RUCO witness, Ms. Diaz Cortez, conceded that Commission
10 Decision No. 67734 does not lock Qwest into a specific way to give consumers the full
11 benefit of the April 1, 2005 adjustment. Reporter's Transcript of Proceedings, Vol. II at
12 480 (Nov. 2, 2005). Ms. Diaz Cortez further admitted that RUCO's proposal (*i.e.*, to
13 reduce certain rates to effectuate the adjustment) is merely RUCO's preference, and is not
14 required by any Commission order or by the existing Price Cap Plan. *Id.* at 486.

15 The Settlement Agreement provides for an immediate \$12 million reduction in
16 Qwest's opportunity to recover its revenue requirement in Year 1 of the Plan, which must
17 be allocated to Basket 2 of the new Price Cap Plan (the location for many of the services
18 previously found in the current Plan's Basket 1). Abinah/RT at 4-8. This amount
19 represents the full value of the April 1, 2005 productivity adjustment. *Id.* It is unlikely
20 Qwest would have used the adjustment to reduce basic residential and business rates as
21 RUCO proposes. *See* Cortez at 6. Under the existing Plan, Qwest has discretion to apply
22 the adjustment to any Basket 1 service it desires. Abinah/RT at 6-7. The Plan does not
23 require Qwest to reduce its basic residential or business rates as RUCO suggests. *Id.*
24 Moreover, given Qwest's revenue deficiency a credit decreasing monthly rates for a
25 particular period, followed by a general increase in rates, would only cause customer
26 confusion. *Id.* at 7-8.

1 Under the Settlement Agreement, however, both residential and business customers
2 benefit from the \$12 million reduction, namely because Basket 2 contains ancillary
3 services and additional lines for both these customer groups. *Id.* at 7. With the application
4 of the adjustment as contemplated by the Agreement, Qwest's opportunity to raise rates in
5 this basket is limited to \$1.8 million in Year 1. *Id.* If the Agreement had not included such
6 an adjustment, Qwest would have been able to generate an additional \$12 million in
7 revenue during the first year of the Plan by increases in Basket 2 service prices. Reporter's
8 Transcript of Proceedings, Vol. I at 133 (Nov. 1, 2005). Thus, customers will benefit from
9 not incurring an increase in rates for certain services that might otherwise have occurred
10 absent the adjustment. Abinah/RT at 7.

11 5. Placement of Services into Baskets 2 and 3

12 RUCO takes issue with the assignment of specific service to Baskets 2 and 3 under
13 the Settlement Agreement and the new Price Cap Plan without making any specific
14 recommendations for alternatives or conducting any independent analysis as to the
15 competitiveness of these services. Rowell/ST at 11. RUCO argues that the Agreement
16 moves additional lines and exchange zone increments associated with additional lines from
17 Basket 1 to Basket 2. RUCO is mistaken in its assertion concerning exchange zone
18 increments. Under the Settlement Agreement, all exchange zone increments are included
19 in Basket 1. Rowell/RT at 9; Thompson/RT at 9. Additionally, Section 13(a) of the
20 Agreement contains a provision to cut the exchange zone increment rates in half. *Id.*

21 More importantly, there is no factual basis to support RUCO's claim that Qwest
22 could somehow acquire "monopoly" status with second lines. All analyses presented at
23 hearing demonstrate that second lines are the subject of significant market competition.
24 Rowell/RT at 9; Rebuttal Testimony of David L. Teitzel at 13-14 (Oct. 28, 2005)
25 ("Teitzel/RT"). Cox, Qwest's primary competitor in urban areas, also offers second lines.
26 Rowell/RT at 9-10; Teitzel/RT at 13. MCI, SBC, Trinsic (f/k/a Z-Tel), and many other

1 CLECs offer multi-line services without pricing distinctions between first and additional
2 lines. Teitzel/RT at 13-14. Wireless phones offer an even greater substitute for second
3 lines, providing service over an even greater geographic area. Rowell/RT at 10. As a
4 result of this intense competitive environment, Qwest has experienced dramatic declines in
5 additional line counts for both residence and business services. Teitzel/RT at 14.

6 RUCO is again mistaken when it claims that caller ID block is moved to Basket 2
7 under the Settlement Agreement. Johnson at 11. Caller ID block remains in Basket 1.
8 Rowell/RT at 10; Thompson/RT at 12. RUCO's criticism of the movement of PBX trunks
9 to Basket 2 is also unfounded. Johnson at 11. PBX trunks are placed in Basket 2 because
10 they are used exclusively by business customers, and primarily large business customers,
11 for whom competition is fierce. Rowell/RT at 10; Teitzel/RT at 11-12. Again, there is
12 widespread competition for PBX services offered throughout Qwest's territory by other
13 carriers, such as AT&T, Cox, MCI, SBC, Time Warner, and XO. Teitzel/RT at 11-12.
14 Qwest's PBX in-service base has declined by nearly 50% between December 2000 and
15 March 2005. Teitzel/RT at 12. Clearly, business PBX customers are finding and using
16 direct alternatives to Qwest, and RUCO offers no justification for its criticism that PBX
17 trunks should not be moved to a more appropriate, competitive basket. Rowell/RT at 10;
18 Teitzel/RT at 12.

19 Similarly, RUCO does not provide any reason why services moved into Basket 3
20 under the Settlement Agreement would not be appropriate, only vague conjecture without
21 supporting facts. Johnson at 13. Moreover, Section 23 of the Settlement Agreement
22 provides safeguards concerning packages that make unlimited price increases on such
23 services impossible. Rowell/RT at 11. Such prices are capped at the sum of the highest
24 prices of the individual services in the package. *Id.* Customers may still buy individual
25 services at approved rates. Direct Testimony of Jerrold L. Thompson in Support of
26 Settlement at 7, n. 1 (Sept. 6, 2005); Rowell/ST at 10-11. Once again, Qwest presented

1 undisputed evidence that Arizona CLECs, wireless carriers and internet telephony
2 providers offer comparable service packages, resulting in a significant and quantifiable
3 collective impact on Qwest's residential and business customer base. Teitzel/RT at 25-28.
4 Thus, RUCO's claim that Qwest will have "complete freedom" to increase the prices of its
5 service packages is simply without basis and frankly absurd. Rowell/RT at 11.

6 **VIII. CONCLUSION**

7 Based on the evidence presented and the foregoing, Qwest requests the Hearing
8 Officer issue a proposed order recommending that the Commission adopt the Settlement
9 Agreement and new Price Cap Plan in their entirety.

10 DATED this 2nd day of December, 2005.

11 FENNEMORE CRAIG

12 By: 

13 Timothy Berg

14 Theresa Dwyer

15 3003 North Central Ave., Suite 2600

16 Phoenix, Arizona 85012-2913

17 (602) 916-5421

18 -and-

19 Norman Curtright

20 QWEST CORPORATION

21 4041 N. Central, 11th Floor

22 Phoenix, AZ 85012

23 *Attorneys for Qwest Corporation*

24 ORIGINAL and 15 copies hand-delivered for
25 filing this 2nd day of December, 2005 to:

26 Docket Control

ARIZONA CORPORATION COMMISSION

1200 West Washington

Phoenix, Arizona 85007

1 COPY of the foregoing hand-delivered
2 this 2nd day of December, 2005 to:

3 Jane Rodda
4 Hearing Division
5 ARIZONA CORPORATION COMMISSION
6 1200 West Washington
7 Phoenix, Arizona 85007

8 Maureen Scott
9 Legal Division
10 ARIZONA CORPORATION COMMISSION
11 1200 West Washington
12 Phoenix, Arizona 85007

13 Christopher K. Kempley, Chief Counsel
14 Legal Division
15 Arizona Corporation Commission
16 1200 West Washington Street
17 Phoenix, AZ 85007

18 Ernest Johnson, Director
19 Utilities Division
20 Arizona Corporation Commission
21 1200 West Washington Street
22 Phoenix, AZ 85007

23 COPY of the foregoing mailed
24 this 2nd day of December, 2005 to:

25 Scott S. Wakefield, Chief Counsel (swakefield@azruco.com)
26 Daniel W. Pozefsky, Esq.
RUCO
1110 West Washington, Suite 220
Phoenix, AZ 85007

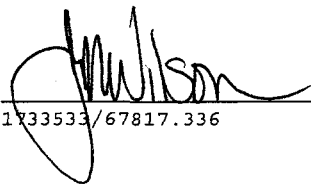
Ben Johnson (bj@benjohnsonassociates.com)
Ben Johnson Associates
2252 Killearn Center Blvd., Ste. 2D
Tallahassee, FL 32309

- 1 Michael W. Patten
Roshka Heyman & DeWulf, PLC
2 One Arizona Center
400 East Van Buren Street, Suite 800
3 Phoenix, Arizona 85004
- 4 Mark A. DiNunzio
Cox Arizona Telcom, LLC
5 20401 North 29th Avenue
Phoenix, Arizona 85027
- 6 Thomas H. Campbell
7 Michael T. Hallam
Lewis and Roca
8 40 N. Central Avenue
Phoenix, Arizona 85004
- 9 Thomas F. Dixon
10 WorldCom, Inc.
707 17th Street, 39th Floor
11 Denver, Colorado 80202
- 12 Peter Q. Nyce, Jr.
Regulatory Law Office
13 U.S. Army Litigation Center
901 N. Stuart Street, Suite 713
14 Arlington, VA 22203-1837
- 15 Richard Lee
Snaveley King Majoros O'Connor & Lee
16 1220 L. Street N.W., Suite 410
Washington, DC 20005
- 17 Walter W. Meek President
18 Arizona Utility Investors Association
2100 N. Central Avenue, Suite 210
19 Phoenix, AZ 85004
- 20 Albert Sterman, Vice President
Arizona Consumers Council
21 2849 E. 8th Street
Tucson, AZ 85716
- 22 Martin A. Aronson
23 Morrill & Aronson, PLC
One East Camelback Road, Suite 340
24 Phoenix, AZ 85012

25

26

1 Brian Thomas
2 Vice President Regulatory
3 Time Warner Telecom, Inc.
4 223 Taylor Avenue North
5 Seattle, WA 98109

6 
7
8
9
10
11
12
13
14
15
16
17
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19
20
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